GA 1.13: AFMD-81-54/Sum.

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Internal Control Weaknesses Contributed To The Mismanagement And Misuse Of Federal Funds At Selected Community Action Agencies

COMPLETED

SUMMARY

GAO found that at 12 community action agencies over $11 million of Federal funds were being either mismanaged or misused. For example:

--Excess cash either had been (1) used to earn (and retain) interest, (2) diverted into unrecorded bank accounts, (3) loaned to other grant programs, delegate agencies, and other governmental units, or (4) used to subsidize nongovernmental activities. In addition one case of embezzlement was noted.

--Transactions with closely related service corporations contributed to the loss of control over Federal funds.

--Funds were used to pay the same expenses twice.

--Assets purchased with Federal funds were lost, stolen, or improperly disposed of.

Some corrective action has been taken including the recovery of nearly $9 million; however, more needs to be done.

AFMD-81-54
JULY 10, 1981

Request for copies of GAO reports should be sent to:

U.S. General Accounting Office
Document Handling and Information
Services Facility
P.O. Box 6015
Gaithersburg, Md. 20760

Telephone (202) 275-6241

The first five copies of individual reports are free of charge. Additional copies of bound audit reports are $3.25 each. Additional copies of unbound report (i.e., letter reports) and most other publications are $1.00 each. There will be a 25% discount on all orders for 100 or more copies mailed to a single address. Sales orders must be prepaid on a cash, check, or money order basis. Check should be made out to the "Superintendent of Documents".

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

INTERNAL CONTROL WEAKNESSES CONTRIBUTED TO THE MISMANAGEMENT AND MISUSE OF FEDERAL FUNDS AT SELECTED COMMUNITY ACTION AGENCIES

D I G E S T

The Federal Government in 1979 provided an estimated $1.5 billion to 897 community action agencies to develop and conduct programs aimed at eliminating poverty and aiding the poor. At the 12 community action agencies reviewed, GAO found that over $11 million of such funds was being mismanaged or misused. The community action agencies reviewed may not be representative of all agencies because their selection was not made statistically. However, the problems identified are indicative of weaknesses in the internal controls used to safeguard Federal grant funds provided to these agencies.

PROBLEM AREAS IDENTIFIED

This report focuses on four problem areas:

--Excessive cash balances.

--Inadequate control over service corporations.

--Duplicate reimbursement of expenses.

--Inadequate control over fixed assets.

Excess cash

GAO reviewed several community action agencies and found that millions of dollars of excess Federal cash had been used to earn (and retain) interest income, had been diverted into unrecorded bank accounts, had been loaned to other grant programs, and had been used to subsidize non-Government activities. In addition, some excess funds were embezzled at one location. At one community action agency, $7.5 million had been retained from expired or terminated grants; at another, employees had diverted $1.9 million into unrecorded bank accounts, loaned over $1 million to other programs and even to other community action agencies in other cities, and

AFMD-81-54

embezzled $120,000; and at a third, $82,000 was used to subsidize the operation of a private enterprise which the community action agency owns. (See pp. 5-10.)

Service corporations

Some of the community action agencies GAO reviewed have used hundreds of thousands of dollars to buy services and rent property from closely related organizations called service corporations. Some of these transactions have resulted in the loss of control over Federal funds and the circumvention of restrictions on the use of grantee funds. The lack of a policy that would require an arm's length relationship between a community action agency and a closely related service corporation contributed to these problems. As a result, one service corporation was able to sell 22 buses for nearly $85,000 and retain the proceeds even though all costs of purchasing and operating the buses were charged to Federal grants. This service corporation similarly also had purchased 33 other buses and two buildings. (See pp. 10-13.)

Duplicate reimbursement of expenses

Some community action agencies and their delegates GAO reviewed have charged nearly $1 million of expenses to more than one Federal grant. For example, one agency received nearly $855,000 in dual reimbursements between July 1974 and May 1977 because it was reimbursed for the same food costs under the Child Care Food program and the Title XX day care program. The grantee had not reported fund reimbursements received from one program to the other even though each program required such reporting. Over $692,000 of this amount was refunded. (See pp. 13-14.)

Lost, stolen, and improperly disposed of assets

Several community action agencies GAO reviewed have not established property control systems to account for assets purchased with Federal funds and have not safeguarded such assets. Consequently, thousands of dollars of assets have been lost, stolen, and improperly disposed of, and neither the community action agencies nor the Federal agencies which fund them know how many assets there should be. For example, at one community action agency, GAO attempted to verify the existence of eight assets purchased in 1978

which cost over $100 each and six assets which cost less than $100 each. None of the 14 could be located. In addition, over $3,000 of assets included in a certified inventory were missing and the property officer knew they were missing when the inventory was submitted to the Community Services Administration. Furthermore, over $9,400 worth of office and photographic equipment contained in the certified inventory could not be located and over $1,400 of assets purchased with Department of Housing and Urban Development funds were missing. (See pp. 14-17.)

WEAKNESSES CONTRIBUTING TO THE MISMANAGEMENT AND MISUSE OF FEDERAL FUNDS

Weaknesses in internal controls enabled the community action agencies GAO reviewed to mismanage and misuse Federal grant funds because:

--Cash was received before it was needed, and Federal grantmaking agencies did not properly monitor grantee cash balances. (See pp. 18-19.)

--The Community Services Administration, prior to September 1980, had not issued any policy instructions which specifically addressed the relationship of community action agencies and their service corporations. (See pp. 19-21.)

--Federal agencies responsible for administering similar programs have not adequately coordinated their efforts, and have not received reliable data on the amount and source of all their grantees' Federal reimbursements. (See pp. 22-23.)

--Federal agencies have not enforced their requirements that grantees establish adequate property control systems. (See pp. 23-24.)

CORRECTIVE ACTIONS BEING TAKEN

The Community Services Administration and the Departments of Health and Human Services and Agriculture have initiated some corrective actions. For example:

--Nearly $9 million of excess cash has been recovered and grantee cash balances are being monitored.

--Safeguards have been introduced to help prevent abuse of service corporations. These safeguards include the incorporation of service corporations as nonprofit entities, the assurance that the assets acquired by these corporations remain in the low income community, the compliance with standard Federal grantee procurement and personnel practices, and the annual auditing of financial records.

--A new application and reporting system to minimize dual reimbursement has been introduced.

--The Office of Management and Budget's uniform requirements for property management have been implemented.

--Interproject loans now require justification and approval.

--Interagency agreements for financial management are being prepared to reduce dual reimbursements.

--An inspectors general joint project is being conducted to study the effects of multiple funding of Federal child care feeding programs. (See pp. 25-26.)

CONCLUSIONS

Good internal controls are the most effective deterrent to mismanagement and misuse of funds. It is apparent from the results of GAO's work that internal controls over Federal funds administered by the community action agencies GAO reviewed need strengthening. The scope of this review would not permit GAO to apply this conclusion to all community action agencies. GAO believes, however, that the corrective action already taken by several Federal agencies as a result of its work indicates that these agencies felt the problems GAO identified existed in more community action agencies than those in this review.

GAO therefore believes that in order to strengthen internal control over Federal funds administered by all community action agencies, Federal grantmaking agencies must establish, revise, and/or enforce sound internal control policies and procedures particularly in the areas of cash management, program cost reimbursements, and property management. In addition, the Community

Services Administration must develop an overall policy governing the establishment of service corporations or similar organizations by community action agencies or their delegates and/or employees. While this policy should include applicable provisions of the Community Services Administration's recent procurement standard amendments, it must also cover nonprocurement contract areas of concern.

GAO also believes that the Office of Management and Budget (OMB) needs to follow up on the Community Services Administration's efforts to regulate service corporations.

RECOMMENDATIONS

The heads of Federal departments and agencies that provide funds directly or indirectly to community action agencies should:

--Enforce the provisions of OMB circulars A-102 and A-110 that deal with establishing a strong system of internal controls at the grantee level.

--Where specific weaknesses exist, develop systems for ensuring that grantees' internal controls are adequate to protect Federal funds from mismanagement and misuse. Such systems should include sanctions which can be applied against grantees who are repeatedly found to have inadequate systems.

--Develop systems to prevent grantees from claiming reimbursement for the same expense under more than one program.

--Follow current cash management policy and recover any excess funds held by grantees.

--Impose sanctions against grantees who repeatedly maintain excessively high balances of Federal cash. Such sanctions may include suspension of cash advances or the charging of interest on excess balances.

--Ensure that grantees adhere to Federal standards relating to property management by periodically receiving their property management systems.

The Director, Community Services Administration, should:

--Develop an overall policy on the establishment of service corporations or similar organizations by community action agencies or their delegates and/or employees. This should minimally (1) require that Federal approval be obtained before any Federal funds are transferred to such an organization and (2) include applicable provisions of the Community Services Administration's procurement standards, particularly those rules that promote the establishment of an arm's length relationship between a buyer and seller.

--Develop monitoring procedures for overseeing the implementation of this overall policy.

--Review service corporations established by community action agencies prior to the issuance of this overall policy to determine if an arm's length relationship exists between the two organizations; where this is not the case, act to bring this into conformity with the new policy and determine if the Government has a residual interest in any property acquired by these service corporations and establish how such interest will be protected.

The Director, Office of Management and Budget, should follow up on the Community Service Administration's efforts to regulate service corporations as part of OMB's budget review process and Financial Priorities Program.

AGENCY COMMENTS
AND GAO'S EVALUATION

GAO provided seven Federal agencies a draft of this report for their review. Comments were not received from the Community Services Administration and the Department of Labor. (See p. 28.) The comments received generally indicated concurrence with GAO's recommendations or discussed actions being taken or planned in response to the problem areas discussed in the report.

OMB agreed that there appears to have been serious weaknesses at the Community Services Administration which permitted the abuse and misuse of Federal funds at community action agencies. OMB

stated that these weaknesses need to be addressed by managers of the various Federal agencies funding these grantees.

OMB, through its circulars, stressed the need for proper accountability of Federal funds, and believed that few of the abuses cited in the report would have occurred if the standards in its Circular A-110 (which covers community action agencies) had been fully implemented. OMB stated that it is following up on agencies' implementation of the provisions of OMB grant management circulars, and is developing a policy circular for agency internal control systems.

OMB also noted that the oversight of the Community Services Administration's efforts to regulate service corporations is an issue that should be resolved by that agency. However, OMB added it will follow up on this issue with the Community Services Administration during the budget review process and as part of its Financial Priorities Program. (See pp. 28-29.)

The Department of Agriculture noted that it is trying to prevent grantees from claiming reimbursement for the same expense under more than one program. Agriculture has negotiated an agreement with the Department of Health and Human Services concerning Head Start. The issue of dual funding with the Health and Human Services Title XX program will be addressed by an amendment to Agriculture's regulations. (See pp. 29-30.)

The Department of Health and Human Services stated that as a result of discussions with the Department of Agriculture, it is developing guidance to prevent grantees from claiming reimbursement for the same expense under more than one program. Health and Human Services also stated that it has written new policies to strengthen grantee cash management practices, and that it will take necessary action, such as providing funds only after periodic receipt of expenditure reports, in cases where grantees continually maintain high cash balances. (See p. 31.)

Contents

		Page
DIGEST		i
CHAPTER		
1	INTRODUCTION	1
	Programs and services provided	1
	Funding sources	1
	Accountability for Federal funds	2
	Objectives, scope, and methodology	2
	Related testimony	3
2	FUNDS GRANTED TO SELECTED COMMUNITY ACTION AGENCIES HAVE NOT BEEN ADEQUATELY MANAGED	5
	Excess cash is retained and misused	5
	Transactions with service corporations contribute to the loss of control over Federal funds	10
	Duplicate reimbursements of expenses	13
	Loss, theft, and improper disposition of assets is prevalent	14
3	WEAKNESSES CONTRIBUTING TO THE MISMANAGEMENT AND MISUSE OF FEDERAL FUNDS	18
	Cash has been withdrawn before needed and balances have not been monitored properly	18
	CSA has only recently issued policies on service corporations	19
	Coordination among similar Federal programs and reliable grantee funding data have not been provided	22
	Federal requirements for adequate property control systems have not been enforced	23
4	CONCLUSIONS, RECOMMENDATIONS, AND AGENCY COMMENTS AND OUR EVALUATION	25
	Conclusions	26
	Recommendations to the heads of departments and agencies funding community action agencies	27
	Recommendations to the Director, Community Services Administration	27
	Recommendation to the Director, Office of Management and Budget	28
	Agency comments and our evaluation	28

APPENDIX		Page
I	November 20, 1978, letter from the Chairman, Subcommittee on Federal Spending Practices and Open Government, Senate Committee on Governmental Affairs	32
II	May 31, 1979, letter from the Chairman, Subcommittee on Federal Spending Practices and Open Government, Senate Committee on Govermental Affairs	34
III	January 29, 1981, letter from the Office of Management and Budget	37
IV	January 29, 1981, letter from the Food and Nutrition Service, Department of Agriculture	39
V	January 29, 1981, letter from the Department of Energy	45
VI	January 28, 1981, letter from the Department of Health and Human Services	46
VII	February 27, 1981, letter from the Department of Housing and Urban Development	50
VIII	The twelve community action agencies whose financial management systems were reviewed by GAO	53
IX	The ten community action agencies whose audit reports were analyzed by GAO	54

ABBREVIATIONS

CPA	certified public accountant
CSA	Community Services Administration
GAO	General Accounting Office
HHS	Department of Health and Human Services
HUD	Department of Housing and Urban Development
OMB	Office of Management and Budget